

New Fiscal Plan for Puerto Rico

Restoring Growth and Prosperity

**As Certified by The Financial Oversight and
Management Board for Puerto Rico**

April 19, 2018

PART III: Restoring growth to the Island

A sustainable fiscal and economic turnaround depends entirely on comprehensive structural reforms to the economy of Puerto Rico. Only such reforms can drive growth in the economy, reversing the negative trend growth over the last 10 years and enabling the Island to become a vibrant and productive economy going forward. To reverse the negative economic trends, the Government must pursue reforms in the following areas:

Human capital and workforce reforms will improve workforce participation, well-being and self-sufficiency of welfare recipients, and preparedness of adults and youth for a long and fulfilling career, resulting in a cumulative GNP impact of 1.00% by FY2023. The impact is enhanced in the long-term as K-12 education reforms begin adding an additional 0.01% GNP impact per year, resulting in an additional 0.16% uptick by FY2048 that continues growing in outer years (to 0.28% by FY2060).

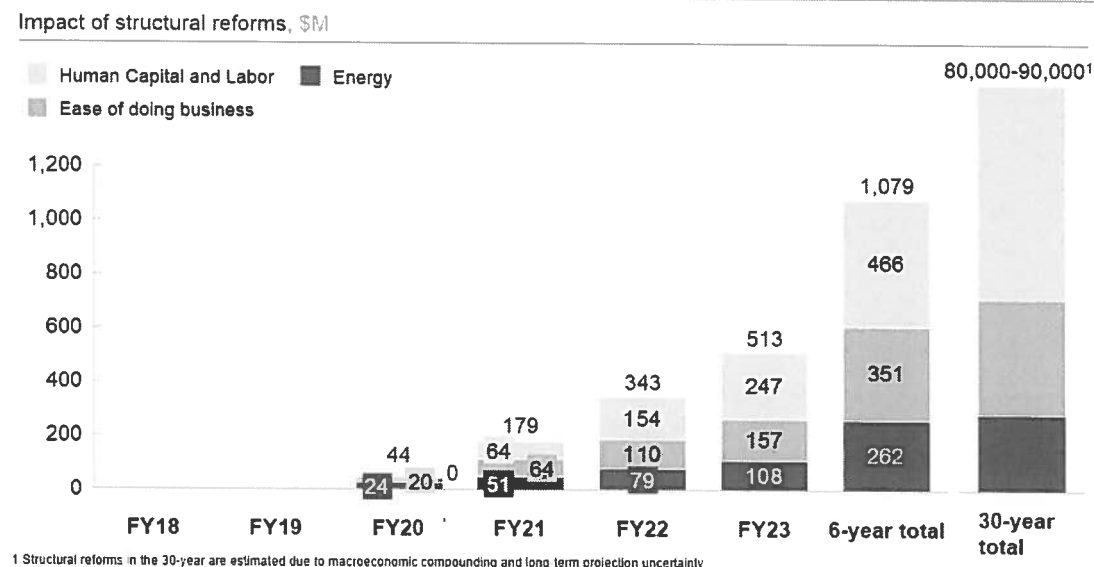
Ease of doing business reforms will improve conditions for economic activity and job creation, employment opportunities, and business vitality, resulting in cumulative GNP impact of 0.5% by FY2023.

Power sector reforms will improve availability and affordability of energy for families and businesses, resulting in 0.30% cumulative GNP impact by FY2023.

Infrastructure reform and capital investment will improve the flow of goods, services, and people across the Island. It has not been scored to provide a specific GNP uptick, yet is undoubtedly a consequential uptick in the Island's long-term development.

If implemented immediately, the structural reforms are projected to result in a sustained 1.80% annual real GNP growth by FY2023. As shown below (**Exhibit 28**), these reforms equal approximately \$80-90 billion in increased Commonwealth revenues over 30 years. In the long term, **education reforms are projected to add an additional cumulative 0.16% to GNP growth, making total impact 1.96% by FY2048.** The reforms are crucial to placing Puerto Rico on a path to long-term structural sustainability.

EXHIBIT 28: IMPACT OF STRUCTURAL REFORMS OVER 30 YEARS



Chapter 7. HUMAN CAPITAL & LABOR REFORM

7.1 Current state of labor / welfare laws and human capital

Puerto Rico faces immense challenges with formal labor force participation and preparedness. The Island's formal labor force participation rate is only ~40%, far from the U.S. mainland average (63%) or even the lowest-ranked U.S. state (West Virginia, 53%), and well below other Caribbean islands. In fact, according to World Bank data, Puerto Rico's formal labor force participation rate is currently 7th lowest in the world and has never ranked higher than the bottom 20.³⁰ Puerto Rico's youth unemployment rate is 23.8%, almost double the world average (13.8%) and more than double the U.S. average (10%).³¹ Low labor force participation in Puerto Rico is a function of neither Hurricane Maria nor the economic downturn that began in 2006; rather, low rates of employment are a long-term structural problem that can be addressed only through significant changes to public policy.

Unless Puerto Rico substantially increases its labor force participation and employment, incomes will always fall far below mainland states and outmigration will continue to draw Puerto Ricans away from the island of their birth. However, if Puerto Rico increased its labor force participation rate even to that of the lowest U.S. state, incomes would rise, poverty would decline, and the budgetary deficit would improve. **While many other reforms are important to making these improvements, increasing labor force participation may be the single most important reform for long-term economic well-being in Puerto Rico.**

7.1.1 Labor laws

Puerto Rico's historically low levels of formal labor force participation cannot be attributed to any single factor, but a range of public policies have served to reduce employment on the Island. Puerto Rico has by far the most generous mandated employer benefits in the U.S., which increase the cost of hiring employees. Unlike Puerto Rico, no mainland states mandate any paid vacation and few mandate even a modest amount of sick leave. No state requires employers to pay a Christmas bonus. Thus, it can be more expensive to employ a low-wage worker in Puerto Rico than on the mainland, making Puerto Rico less competitive in labor-intensive sectors such as tourism.

Economists have documented that when employers are required to provide an employee benefit, those employers will tend to recoup the costs of those benefits by reducing the wages paid to employees.³² When employers are prevented from reducing wages to offset costs of

³⁰ Puerto Rico ranking has never surpassed 215th out of the 232 countries, states, and territories tracked by The World Bank Group since The World Bank Group began collecting data in 1990

³¹ The World Bank Group, 2017, via International Labour Organization, ILOSTAT database. Data retrieved in March 2017. <https://data.worldbank.org/indicator/SL.UEM.1524.ZS>

³² This has been shown to be true with employer-paid Social Security taxes, health coverage, maternity leave, and other benefits. For instance, the Congressional Budget Office and the Social Security Administration both assume that an increase in Social Security payroll taxes levied on employers would result in a roughly dollar-for-dollar reduction in employee wages. Likewise, when the Affordable Care Act ("Obamacare") was projected to reduce the rate of growth of employer health care costs, the Social Security and Medicare Trustees assumed that this would be reflected in increased wages paid to employees. Gruber and Krueger (1991) found that employer costs for workers compensation insurance are largely shifted to employees via lower wages. Gruber (1994) found that when employers were required to provide maternity health benefits to employees, wages for employees declined by a similar amount. Prada et al (2017) found that when Chile required employers to provide free child care, wages for women declined by 9 to 20 percent. Kolstad and Kowalski (2016) found that when Massachusetts required employers to provide health insurance, wages for employees declined by an amount similar to the health premiums paid by employers. (Gruber, Jonathan, and Alan B. Krueger. "The incidence of mandated employer-provided insurance: Lessons from workers' compensation insurance." *Tax policy and the economy* 5 (1991): 111-143. Gruber, Jonathan. "The incidence of mandated maternity benefits." *The American economic*

mandated benefits, as may be the case with a minimum wage worker, they may choose to reduce the number of workers they hire. Thus, it is reasonable to assume that Puerto Rico's high levels of mandated employer-paid benefits reduce both wages and employment relative to a scenario in which such benefits were not required.

Likewise, there is evidence that employer benefit costs can increase the size of the informal labor market, where income is not reported and such benefits need not be provided.³³ About one quarter of Puerto Rican workers participate in the informal economy according to Estudios Técnicos, substantially higher than any mainland state.³⁴

In addition to costly mandatory employer-provided benefits, Puerto Rico lacks "at-will employment," which would make it easier for employers to dismiss unsatisfactory employees. While there are variations in labor laws among the 50 mainland states, 49 of them adopt some form of at-will employment. In Puerto Rico, employers generally must first prove "just cause" before dismissing employees. This can produce litigation, and many employers simply pay severance pay to an unsatisfactory employee to avoid a court dispute.

While some employees benefit from Puerto Rico's lack of at-will employment, this policy makes it more costly and risky not only to dismiss, but also to hire, an employee. There is evidence that such job protections lower employment opportunities. For example, studies have found that laws preventing unfair dismissal caused reductions in employment, particularly in labor-intensive industries;³⁵ and in U.S. states, a recent study found that expanding unfair dismissal protections caused employers to shift away from using less-skilled workers and toward greater use of capital investments and more-skilled labor. When Colombia reduced the cost of dismissing workers, unemployment fell and the size of the informal labor force declined.³⁶ In a 2003 book on labor laws in Latin America and the Caribbean, Nobel Prize-winning economist James Heckman concluded that

"mandated benefits reduce employment and... job security regulations have a substantial impact on the distribution of employment and on turnover rates. The most adverse impact of regulation is on youth, marginal workers, and unskilled workers. Insiders and entrenched workers gain from regulation but outsiders suffer. As a consequence, job security regulations promote inequality among demographic groups."

The Government has recently made strides to improve labor market conditions with the Labor and Flexibility Act (Act 4-2017) in January 2017, which added flexibility to overtime regulations and increased work requirements to become eligible for Christmas Bonus and severance pay, among other reforms. Notwithstanding such reforms, Puerto Rico's labor laws remain by far the most burdensome in the U.S. The Island still requires a Christmas bonus and severance payouts, mandates 27 days of paid leave per year, and is not an employment at-

review (1994): 622-641. Prada, María F., Graciana Rucci, and Sergio S. Urzúa. The effect of mandated child care on female wages in Chile. No. w21080. National Bureau of Economic Research, 2015. Kolstad, Jonathan T., and Amanda E. Kowalski. "Mandate-based health reform and the labor market: Evidence from the Massachusetts reform." *Journal of health economics* 47 (2016): 81-106.)

33 Kugler et al (2017) found that a reduction in employer payroll taxes in Colombia reduced the size of the country's informal labor market. Kugler, Adriana, Maurice Kugler, and Luis Omar Herrera Prada. "Do payroll tax breaks stimulate formality? Evidence from Colombia's reform." No. w23308. National Bureau of Economic Research, 2017

34 Estudios Técnicos, Inc, "The Informal Economy in Puerto Rico," August 9, 2012

35 RAND Corporation, 1992

36 Kugler (2004). See Dertouzos, James N., and Lynn A. Karoly. "Labor market responses to employer liability." Rand Corporation, 1992; Autor, David H., William R. Kerr, and Adriana D. Kugler. "Does Employment Protection Reduce Productivity? Evidence from U.S. States." *The Economic Journal* (2007): F189-F217; Heckman, James. Law and employment: Lessons from Latin America and the Caribbean. No. w10129. National Bureau of Economic Research, 2003; Kugler, Adriana D. "The effect of job security regulations on labor market flexibility. Evidence from the Colombian Labor Market Reform." In *Law and Employment: Lessons from Latin America and the Caribbean*, pp. 183-228. University of Chicago Press, 2004

will jurisdiction, imposing costs and regulatory burdens that reduce employment, wages and economic opportunity.

7.1.2 Welfare policies

In addition to the Island's labor laws, Puerto Rico residents may also face disincentives to participate in the formal labor market due to rules attached to various welfare benefits, including the Nutritional Assistance Program (PAN), Mi Salud (Medicaid), Section 8 public housing, TANF, WIC, and other programs.

These benefits are sometimes stereotyped with a claim that "welfare pays more than work." While this may be true in isolated cases, the broader problem occurs when welfare beneficiaries work in the formal sector and receive earnings, which triggers a reduction in their benefits. The phase-out of government transfer benefits as earned income increases acts as a tax to disincentivize formal employment, as effective hourly wage (income received by working minus the loss of benefits) can be substantially lower than the formal hourly wage received. For many citizens, working in the informal sector and collecting transfer benefits can often result in higher effective income than working in the formal sector.

While transfer benefits in Puerto Rico are not more generous than on the mainland in dollar terms, they *are* more generous relative to generally lower earnings on the Island. When benefits are phased out as a beneficiary works, loss of benefits may be larger relative to earnings than for a mainland worker. This can serve as a greater disincentive to work than on the mainland.

It is difficult to quantify how large such disincentive effects may be due to limitations on the data available. Different individuals entitled to different sets of benefits are thus faced with different incentives should they work. It is reasonable to conclude that for many welfare beneficiaries, formal sector work may sometimes do little to increase household incomes.

For individuals receiving food stamps, Mi Salud, TANF and public housing, it often makes little financial sense to work at the minimum wage in the formal sector. For a full-time minimum wage worker the loss of benefits will offset most or all income received from work, leaving the household no better off.³⁷

Though few Puerto Rico residents receive all these benefits,³⁸ even receipt of a single type of benefits can alter incentives to engage in the formal workforce. For instance, a single mother with two children and annual income below \$4,900 is eligible to receive approximately \$4,229 in annual PAN ("food stamp") benefits. But should that individual work 35 hours per week at the minimum wage, her annual earnings of \$12,180 would cause her to lose eligibility for food stamps. Net of taxes on her earnings, working full-time would increase her household's annual income by only \$7,002, equivalent to an hourly wage of only \$3.86. Under those conditions, some individuals may choose not to work in the formal labor market.

Even when TANF and Section 8 housing benefits are excluded, monthly income paid to a minimum wage worker with two children is only \$329 greater than what he or she could

³⁷ Burtless, Gary, and Orlando Sotomayor. "Labor supply and public transfers." In *The Economy of Puerto Rico: Restoring Growth* (2006): 82-151

³⁸ See Héctor R. Cordero-Guzmán, "The production and reproduction of poverty in Puerto Rico," in Nazario, Carmen R., ed. *Poverty in Puerto Rico: A Socioeconomic and Demographic Analysis with Data from the Puerto Rico Community Survey* (2014). Inter American University of Puerto Rico, Metro Campus, 2016. Cordero. Notes that the number of TANF beneficiaries in Puerto Rico is relatively modest and many, due to age or disability, are unlikely to work under any conditions

receive from government benefits.³⁹ In this example, effective hourly pay (the amount received from working more than what the individual could receive from government benefits without working) is only about \$2.35.

Mainland states face many of these same incentive issues, which they address in two ways. First, residents of mainland states are eligible for the Federal Earned Income Tax Credit (EITC), which provides a partial refund against Federal income taxes for eligible low-income workers. Many states supplement the Federal EITC to increase benefits to recipients. By increasing the reward to work, the EITC has been shown to increase labor force participation.⁴⁰ However, because Puerto Rico residents do not pay Federal income taxes they are not currently eligible for the Federal EITC.

Likewise, the Federal Government requires that food stamp programs on the mainland (Supplemental Nutrition Assistance Program, "SNAP") contain a work requirement. In general, working-age SNAP beneficiaries on the mainland must register for work, cannot turn down a job if offered, and may be required by the state to attend education or work training classes. In addition, Federal law requires that non-disabled adults without dependents must work, attend education, or volunteer at least 20 hours per week to maintain eligibility for benefits.

Puerto Rico's labor and welfare laws may help explain why, despite the Island's natural beauty, attractions and ease of access from the U.S. market, employment in tourism-related industries is low. According to the Federal Bureau of Labor Statistics (BLS), Puerto Rico employs only 80,000 individuals in the leisure and hospitality industries – 10,000 fewer tourism-related jobs than the state of Nebraska, which both lacks Puerto Rico's natural assets and has an overall population over one-third smaller than Puerto Rico.

7.1.3 Workforce preparedness

Finally, Puerto Rico's potential workforce is also not well prepared to fill jobs currently needed by the economy, according to a report by the Federal Reserve Bank of New York.⁴¹ For example, reconstruction efforts in the wake of Maria rely heavily on external contractors from the mainland U.S., as the skills needed are not readily available on the Island. Puerto Rico currently does not ensure proper skill development for youth and adults to fill high-demand roles based on current economic needs.

Puerto Rico has therefore not solved the supply or demand side issues with its labor market – a huge barrier to economic growth and sustainability for the Island.

7.2 Future vision for the Puerto Rican labor market

Changes to labor and welfare laws are controversial. It is difficult to ask Puerto Rican residents to give up benefits and job protections when, through the economic downturn and then Hurricane Maria, they already have lost so much. Nevertheless, dramatic changes to Puerto Rico's labor market policies are necessary to provide opportunity for a greater standard of living at home, reversing the Island's history of high poverty, constrained budgets, and pressure for young Puerto Ricans to leave their home for the mainland.

³⁹ Advantage Business Consulting. "Beneficios de las Personas Elegibles al TANF vs. Escenario de Salario Mínimo Federal." Prepared for the Universidad Interamericana, May 2015

⁴⁰ See Eissa, Nada, and Jeffrey B. Liebman. "Labor supply response to the earned income tax credit." *The Quarterly Journal of Economics* 111, no. 2 (1996): 605-637

⁴¹ Federal Reserve Bank of New York, "An Update on the Competitiveness of Puerto Rico's Economy." July 31, 2014. <https://www.newyorkfed.org/medialibrary/media/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf>

The New Fiscal Plan builds upon policies proposed by Governor Rosselló in the Government's Draft Fiscal Plan Submission in March 2018, but with several substantial adjustments.

To ensure Puerto Rico can provide opportunities for its people for years to come, structural reforms must make it easier to hire, encourage workforce participation, and enhance student outcomes and workforce development opportunities to ensure a pipeline of prepared and appropriately-skilled individuals. The Government should aim to **increase the labor force participation rate to 47% and reduce the youth unemployment rate to 20.2% by FY2023**. In both cases, these results would roughly halve the current gap between Puerto Rico and the lowest U.S. state (West Virginia).

By achieving these goals, the Government should increase household incomes, cut the poverty rate and reduce incentives to emigrate to the mainland. Moreover, successful labor market reforms are projected to approximately \$50 billion in additional revenues by FY2048 and over ~\$460 million from FY2018-23, which is an approximately \$330 million increase in surplus over the limited labor reform package proposed by the Rosselló Administration.⁴² Therefore, by implementing the labor market reforms contained in the New Fiscal Plan, the Government of Puerto Rico will be able to reinvest over the next three years into the well-being of the people of Puerto Rico through improved healthcare outcomes and investment in education and youth workforce development programs (*discussed in Chapter 11*) to drive growth.

7.3 Structural reform initiatives to change labor conditions

Labor market reforms will increase the availability of jobs while increasing incentives and preparedness to work. To accomplish this broad-based reform, the Government must implement flexible labor regulations, reform welfare including an earned income tax credit (EITC) for low-income workers and a work requirement for able-bodied PAN beneficiaries, and implement programs to develop critical skills in the workforce.

7.3.1 Flexible labor regulations

To reduce the cost to hire and encourage job creation, including movement of informal jobs to the formal economy, Puerto Rico must become an employment at-will jurisdiction, reduce mandated paid leave (including sick leave and vacation pay) by 50%, and make the Christmas Bonus voluntary for employers.

- **At-will employment (in place by January 1, 2019):** 49 out of 50 U.S. states are employment-at will jurisdictions, giving employers the flexibility to dismiss an employee without having to first prove just cause. Matching this policy will lower the cost and risk of hiring in Puerto Rico.
- **Reduction of mandated paid leave, including sick leave and vacation pay (effective immediately):** Most U.S. states do not mandate any vacation or sick leave. The Government shall halve mandated vacation and sick leave, resulting in 14 days per year of vacation and sick leave in a move to align worker protections with typical mainland labor policies. Paid maternity leave under current law will be retained.
- **No mandated Christmas bonuses (eliminated by January 1, 2019):** The current requirement to pay an annual Christmas bonus to employees must be eliminated. Employers may continue to pay bonuses on a voluntary basis, as is the case on the mainland.

⁴² Government proposed labor reform package creates 0.25% GNP growth total beginning in FY2021. Comprehensive labor reform as described in this Fiscal Plan is projected to result in total 1.0% GNP growth by FY2022

Unlike Act 4, in order to achieve the growth projected by this New Fiscal Plan, the above proposals must apply to all workers, current and future hires, equally. These programs should reduce friction in the labor market and reduce the cost of hiring workers in Puerto Rico.

7.3.2 Minimum wage increase

To offset some of the reduced protections and compensation for employees in Puerto Rico, these reforms can be accompanied by a modest increase in the minimum wage for workers 25 and over. Under the proposal, the minimum wage would increase by \$0.25 per hour, effective as soon as the Christmas bonus is made voluntary. Workers under age 25 would remain at the Federal minimum wage of \$7.25 to increase opportunities for youth to gain valuable experience and skills in the workforce and avoid worsening the high youth unemployment rate. Small employers as defined by Act 120-2014 are also exempt from the increase.

Additional increases in minimum wage should be implemented under the following conditions:

- For all workers 25 years old and over, an additional \$0.25 per hour if Puerto Rico's labor participation rate exceeds 45% as measured by BLS;
- For all workers 25 years old and over, an additional \$0.25 per hour if Puerto Rico's labor participation rate exceeds 50% as measured by BLS; and
- For all workers 25 years old and over, an additional \$0.25 per hour if Puerto Rico's labor participation rate exceeds 55% as measured by BLS.

This timeline and conditions ensures that minimum wage increases occur at a pace and under conditions in which a higher minimum wage will not adversely affect job opportunities for lower-income workers.

7.3.3 Welfare structure reforms

To implement the labor reform package, address labor market challenges and encourage residents to participate in the formal labor market, the Government must launch an Earned Income Tax Credit (EITC) program by January of 2019, raising pay for formal laborers. The Government also must institute a work requirement for the Nutrition Assistance Program (PAN) by July 1, 2018, with no transition period (e.g., full requirements regarding work will begin in July).

Earned Income Tax Credit (EITC)

The EITC is a benefit for working people with low to moderate income. To qualify, people must meet certain requirements and file a tax return, even if they do not owe any tax. The EITC reduces the amount of taxes owed and may result in a cash refund if the benefit is higher than owed taxes.

Since welfare reform in 1996, the EITC has become the cornerstone of anti-poverty policy in the United States. It has refocused the U.S. safety net on working families, dramatically increasing employment among single women with children and removing more children from poverty than any other program. In the U.S., this translates to approximately 6.5 million people (half of whom are children) lifted out of poverty. Further, the EITC improves employment rates (a \$1,000 increase in EITC benefit has been tied to a 7.3 percent increase in employment)⁴³ and provides increased opportunities for individuals to invest in their own

⁴³ Hoynes and Patel 2015, <http://www.taxpolicycenter.org/briefing-book/how-does-eitc-affect-poor-families>

futures with education, training, childcare, or other costs that improve longer-term outlook. It has proven a powerful incentive to transition into the formal labor force and file taxes.

From 2006 to 2014, Puerto Rico had a Worker's Tax Credit, which was later discontinued due to its ineffective application and as a cost saving measure. This prior Work Credit applied to 45% of all tax filers at a cost of \$152 million in its last year of implementation. It was smaller than Federal EITC programs (\$150-450 versus ~\$2,000 average credit), and did not eliminate high implicit tax rates on low-income employees or do enough to incentivize formal employment.⁴⁴

In Puerto Rico, implementation of the new EITC should be similar to the Federal EITC but adjusted to the relative wages of the Island. Eligible recipients should receive credits according to their marital, family, and earned income. As earnings increase, the benefit should increase up to a specified cap; at the cap, it would plateau and eventually decrease at the phase-out income level until it reaches \$0 (**Exhibit 29**), resulting in an average benefit of \$525.30 per individual per year. This structure diminishes the "benefits cliff" many face as their earned income increases, rewarding citizens who participate in the formal economy.

EXHIBIT 29 EITC BENEFIT FORMULA

EITC Benefit Formula, \$

- Benefits begin with the first dollar of reported income. As income increases, **benefits also increase at the phase-in rate** (different depending on household size), **up to the maximum credit**
- When income reaches the phase-in cap, the benefit increase ceases. Benefits remain constant at income levels that fall between the phase-in cap and phase-out start
- When income reaches the phase-out start, **benefits begin decreasing at the phase-in rate** for each additional dollar earned, until income reaches the income cap (at which point benefits are \$0)

Number of Children	Phase-in rate, %	Phase-in cap, \$	Phase-out start, \$	Individual/ Single income cap, \$	Married income cap, \$	Maximum Credit, \$
0	5.00%	6,000	18,000	20,500	21,750	300
1	7.50%	12,000	13,000	20,500	24,250	900
2	10.00%	15,000	16,000	28,500	34,750	1,500
3 or more	12.50%	16,000	17,000	33,500	42,000	2,000

For example, a single mother with two children working at minimum wage for 35 hours per week earns approximately \$12,180 annually. With EITC, she can qualify for up to \$1,500 in additional take-home pay per year, effectively raising the minimum wage by more than 12%.

The EITC program would cost approximately \$200 million per year, but the program will raise formal labor force participation significantly, providing a positive return on the investment. The EITC must be implemented no later than FY2019.

PAN Work requirement

While PAN, Puerto Rico's largest welfare program, is similar to the mainland SNAP, it is funded and administered separately and does not include a work requirement. As part of the labor reform package that the Oversight Board projects will create substantial growth over the

⁴⁴ New York Federal Reserve Bank, 2014

next 30 years, the New Fiscal Plan requires that the Government institute work requirements to qualify for PAN benefits.

In FY2019, able-bodied participants aged 18-59 will be subject to a work requirement (children, even if their parents do not work, will continue to receive the benefit). Like mainland SNAP, in full implementation this work requirement must become effective after the individual has collected PAN benefits for three months. General exceptions would include those under age 18 or over the age of 60, parents with dependents under age 18, as well as those who are medically certified as physically or mentally unfit for employment. Paid work, voluntary work, training and education, and job searching (under the time limit) must qualify as work.

Any program savings derived from the PAN work requirement must be redistributed to working beneficiaries, effectively increasing take-home pay for workers. The increased worker benefit shall take place through an expansion of the Earned Income Disregard, which will increase the amount of earned income eligible recipients can exclude in calculating the amount of benefits they can claim. For example, a family of four currently receiving PAN will lose the benefit after exceeding a maximum annual income of \$5,904. By creating a sliding scale after this amount, or allowing families to exclude a certain amount of earned income from this calculation, Puerto Rico can ensure no one is disadvantaged by seeking work in the formal economy and that no families lose benefits prematurely.

The increase in PAN benefits for workers combined with the EITC and modest minimum wage increases would improve conditions for low-income workers in the formal economy and reduce poverty.

The proposed PAN work requirements must be included in the new PAN annual plan submitted July 1, 2018 to Food and Nutritional Services. It will be phased in over two years. Beginning in FY2019, beneficiaries will be subject to the work requirement after 6 months of benefits. By FY2020, the full requirements will take effect, subjecting beneficiaries to the work requirement after 3 months of benefit collection.

7.3.4 Workforce development programs

Labor and welfare reforms should increase supply and demand for jobs; to fully close the gap and implement the labor reform package, however, the Government must launch specific efforts to ensure that its future workforce is prepared with critical skills.

Workforce Innovation and Opportunity Act (WIOA)

First, the Government must update the WIOA State Plan to focus its programs and incentives on high-priority sectors and capabilities (e.g., aerospace, software development, and creative services). WIOA is the primary way in which the Federal Government invests in adult education and workforce development, and it is designed to help jobseekers access employment, education, and support services to succeed in the labor market, and to match employers with the skilled workers they need. The Government must broaden the list of core industries that qualify under WIOA, and focus on high impact economic sectors to provide a skilled workforce that meets the needs of employers in each specific region. It shall integrate this WIOA program with the broader promotional efforts of the Department of Economic Development and Commerce (DDEC). For example, an MOE Agreement with the Puerto Rico Department of Labor and Human Resources shall establish an apprenticeship program aiming to impact innovative industries and post-Maria labor market needs.

Youth development initiatives

In addition to WIOA, the Government should help develop critical skills in the workforce through multiple proposed initiatives, including:

- **Youth development:** Investment in STEM through targeted teacher professional development and related programs; apprenticeship programs through partnership with universities and local businesses; opportunities for work-based learning and business programs; occupational opportunities and certification programs (funded through reinvestment in additional surplus achieved through comprehensive labor reform)
- **Higher education:** Curriculum development grants and scholarships for UPR students focused on high-impact sectors, e.g., the IT industry and Computer Science.
- **Current labor market:** Apprenticeship Programs through collaboration with the private sector; training & certification programs focused on the areas of reconstruction efforts; creation of a job council to coordinate development and employment opportunities for youth and the unemployed

By pursuing aggressive reforms to incentivize job creation and formal labor market participation, and to improve the overall quality of human capital in Puerto Rico, the Government will fundamentally transform the Island's labor market for the better.

7.4 Implementation and enforcement of human capital and labor reform

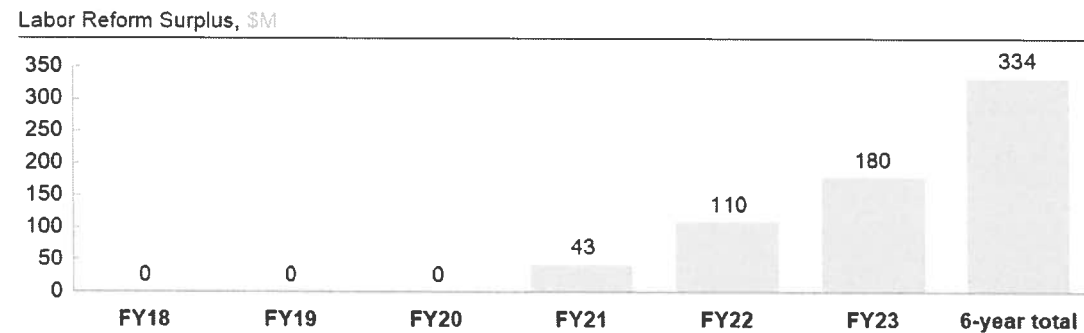
The New Fiscal Plan is built on the assumption that, by no later than May 31, 2018, the Legislative Assembly of Puerto Rico will pass the Labor Reform Package and present it to the Governor of Puerto Rico for his signature (the "Condition").

The Labor Reform Package is defined as all bills, whether new Commonwealth legislation or amendments to existing Commonwealth legislation, that are necessary and proper to effectuate the Labor Reform Agenda. The Labor Reform Agenda is defined as the following policies and reforms:

- Institution of at-will employment (effective by January 1st, 2019)
- Reduction of mandated paid leave, including 50% reduction in sick leave and vacation pay (effective immediately)
- Shift of Christmas bonus from mandatory to voluntary status (by January 1st, 2019)
- Earned Income Tax Credit (starting July 1st, 2018)
- Increase minimum wage for workers 25 and over by \$0.25 per hour (effective with Christmas Bonus elimination)
- PAN work requirement and work bonus (effective by January 1st, 2019)

The Labor Reform Agenda is projected to generate short-term revenue of ~\$460 million through FY2023. This represents an approximately \$330 million increase in revenues over the labor reform package initially proposed by the Government over the period covered by the New Fiscal Plan (the "Labor Reform Surplus;" **Exhibit 30**). In the long term, the Labor Reform Agenda will drive substantial economic growth and ~\$50 billion in surplus.

EXHIBIT 30: LABOR REFORM SURPLUS FOR REINVESTMENT



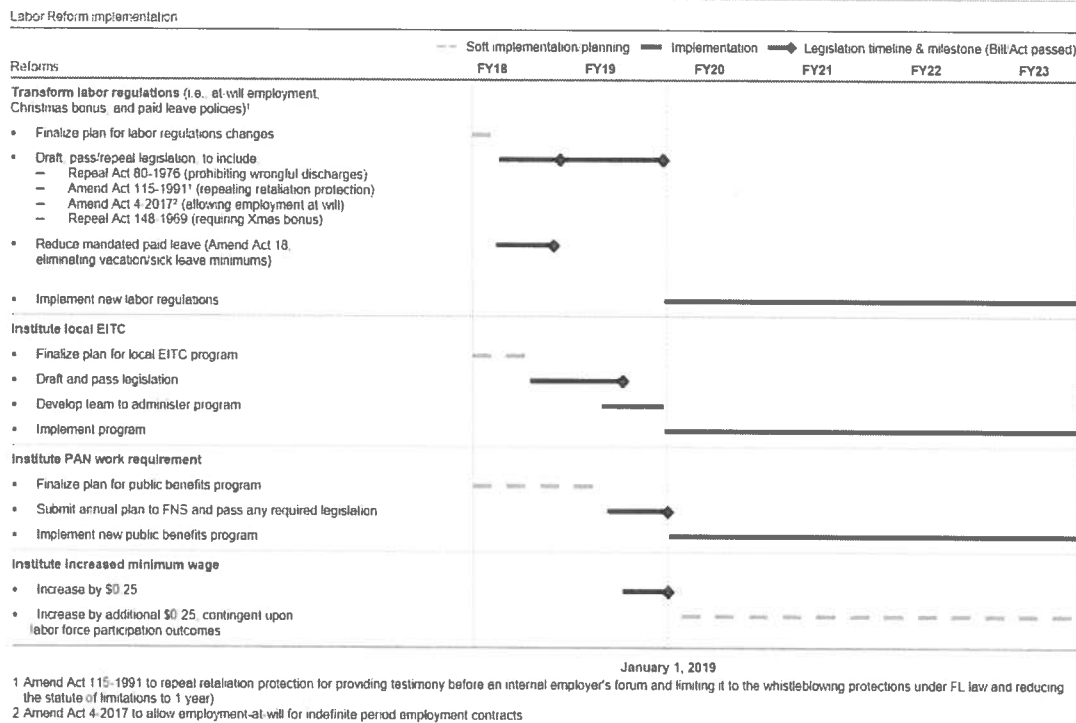
If the Condition is met, the Labor Reform Surplus shall be used to fund initiatives led by the Government to reinvest in the people of Puerto Rico that improve the Island's health outcomes and provide the education and workforce development some Puerto Ricans will need to be prepared for newly created jobs (*see Chapter 11 for more details*):

- Reinvestment in ensuring success of healthcare reforms totaling \$353M
- Reinvestment in K-12 education and human capital development programs such as STEM grants and K-12 STEM training, totaling \$160M

While reinvestment will total over \$500 million over three years, due to macroeconomic trends and Federal funds flows affecting reinvestment and measures, these funds spent will decrease the total 6-year surplus by only ~\$330 million (equivalent to the Labor Reform Surplus). The reinvestments are crucial to the overall success of structural reforms and create long-term economic growth in the economy.

If, for any reason, the Oversight Board determines in its sole discretion that the Condition has not been met, and the Oversight Board has not determined in its sole discretion to modify the Condition (the "Consequence"), then the Labor Reform Surplus will not be available and these reinvestment opportunities will not be made.

EXHIBIT 31: LABOR REFORM IMPLEMENTATION TIMELINE



Chapter 8. EASE OF DOING BUSINESS REFORM

8.1 Current state of business regulation and investment attraction

One of the strongest means of increasing economic growth is through improving the ease of starting and expanding a business. A commerce environment with easier-to-navigate regulations, permits, and other legal requirements is friendlier to new businesses that can provide jobs, tax revenue, and economic stimulus. To quantify a jurisdiction's overall effectiveness at maintaining the optimal level of business regulation, the World Bank created the Doing Business Index, which ranks 190 countries and entities worldwide on several core indicators. Countries and territories that have been able to meaningfully improve their ranking have shown real growth. For example, when the Republic of Georgia improved its ranking from #98 in 2006 to #8 by 2014, output per capita increased by 66% and business density tripled. Meanwhile, ease of doing business remains an area in which Puerto Rico has much room for improvement.

In the 2018 Ease of Doing Business Report, Puerto Rico was ranked 64th. This represents a 9-point decline from 2017 and is 58 spots lower than the U.S., which ranks 6th overall. There are some areas of strength: Puerto Rico placed 6th for Getting Credit and 9th for Resolving Insolvencies. It has also made recent efforts to digitize government services to improve speed and accessibility, having digitized 27% of licenses transferred to the Unified Information System (SUI, a central and digital location for applications for licenses, incentives, autonomous municipalities, etc.) as of August 2017. However, when compared to the mainland, Puerto Rico has several areas for improvement, in particular: